

PUBLIC UTILITIES COMMISSION

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Federal Communications Commission
1919 M St., N.W. Room 222
Washington, D.C. 20554

Re: CC Docket No. 96-45

Gentlemen:

Please find enclosed for filing an original plus four copies of the COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ON THE RECOMMENDED DECISION in the above-referenced docket.

Also enclosed is an additional copy of this document. Please file-stamp this copy and return it to me in the enclosed, self-addressed postage pre-paid envelope.

Yours truly,

A handwritten signature in cursive script that reads "Mary Mack Adu".

Mary Mack Adu
Attorney for California

MMA:mbh

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WASHINGTON, D.C. 20554

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| In the Matter of |) | FCC 96-93 |
| |) | |
| |) | CC Docket No. 96-45 |
| Federal-State Joint Board on |) | |
| Universal Service; |) | |
| _____ |) | |

**COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA
AND THE PUBLIC UTILITIES COMMISSION
OF THE STATE OF CALIFORNIA
ON THE RECOMMENDED DECISION**

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December 18, 1996

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I. INTRODUCTION

The People of the State of California and the Public Utilities Commission of the State of California ("California" or "CPUC") hereby respectfully submit these comments to the Federal Communications Commission ("FCC" or "Commission") on the Recommended Decision by the Federal-State Joint Board on Universal Service. The Recommended Decision proposed rules and policies to ensure that telecommunications services are available at affordable rates in the new competitive telecommunications market. The Recommended Decision proposed policies on a broad range of topics including support for rural, insular and high cost areas, low income customers, schools and libraries and health care providers. These comments are in response to a Public Notice issued by the FCC's Common Carrier Bureau seeking comment on the Recommended Decision.

II. SUMMARY

California generally supports the Joint Board's Recommended Decision. California is concerned, however, about some specific elements of the Joint Board's proposal. First, California believes that the proposed high cost assistance program should be more narrowly directed to provide support to truly high cost areas. Second, the Commission should coordinate low income assistance programs with states. Third, the Commission should carefully consider the technical and legal problems associated with assessing the

intrastate revenue of providers of interstate telecommunications to fund the federal universal service program.

III. DISCUSSION

A. The High Cost Assistance Fund

California believes that the Joint Board proposed an appropriate framework for distributing high cost assistance, but that the proposal may result in a program of inappropriate scope. The basic concepts of the Joint Board's proposed approach are sound. Federal support should be based on forward looking economic costs and should be available to all carriers willing to accept eligible carrier obligations. High cost assistance should also be restricted to primary lines. In its general outlines, the Joint Board's proposed program is similar to that recently adopted by the California PUC in Decision (D.)96-10-066. California believes that, with modifications to the Joint Board's proposal, state programs, such as California's and the federal programs, can complement one another.

California has several specific concerns with the Joint Board's high cost proposal. The CPUC believes that the appropriate role for the federal universal service fund is to provide assistance only to the nation's high cost areas, areas that without federal intervention would experience rates that would not be generally affordable. We fear that the Joint Board's proposal may result in a federal universal service of a larger scope than necessary to ensure affordable rates. California also believes that the Joint Board did not recognize the states'

discretion in determining eligibility for federal high cost assistance. Finally, California would like to offer some suggestions concerning costing methods based on its experience with proxy models.

1. The Scope of the New Federal High Cost Assistance Program Should be Narrowly Defined

California believes that the Act provides guidelines for determining the appropriate scope of the federal high cost assistance program. These guidelines suggest modest, targeted intervention in the market when necessary to promote universal service. These guidelines are articulated through the Act's universal service principles. The Act advances the principle that "quality services should be available at just, reasonable and affordable rates." (254(b)(1)) With respect to rural and high cost areas, the Act adds the principle that consumers in these areas should have access to telecommunications services, "at rates that are reasonably comparable to rates charged for similar services in urban areas." (254(b)(3)) California believes that these two principles indicate that the Commission should intervene in the market place only when affordability or comparability of rates between urban and rural areas are threatened. In other words, federal high cost assistance should be directed to truly high cost areas and should be the exception, not the norm.

The Act does not mandate that rates should be the same in high cost and low cost areas. The Act indicates that rates for access should be "reasonably comparable" between urban and rural areas, not identical. This fact is driven home by contrasting sections 254(b)(3) and 254(g). Section 254(g) unequivocally

states that the Commission shall adopt rules to “require that rates charged by providers of interexchange telecommunications services to subscribers in rural and high cost areas shall be no higher than the rates charged by each such provider to its subscribers in urban areas.” (254(g)) Section 254(b)(3) creates no similar mandate for identical rates for access. In California, rates vary between companies serving different areas. The California Legislature gave the CPUC a numeric guideline for addressing comparable rates by indicating that the CPUC shall establish a rate structure for small rural telephone companies that are no greater than 150% of those paid by consumers in urban areas.¹

The Act indicates that any necessary universal service support shall be explicit. (254(e)) This does not mean that every alleged implicit subsidy should be replaced with a new “explicit” one of equal value. Since these subsidies will ultimately be recovered through rates, much in the same way they are today, very little may be gained in that exercise. More importantly, it is not incumbent on the FCC to replace these alleged subsidies when they are derived from intrastate services. The Act’s universal service provisions suggest that universal service programs be designed to achieve specific goals, such as affordability, without reference to other aspects of the rate structure.

The Act also clearly contemplates complementary state universal service programs, such as the one California has recently adopted. Section 254(f) indicates that states have authority to implement universal service programs as

¹ California Stats. 1987, ch. 755, Sec.1(d).

long as they do not burden the federal program. The Act allows latitude for states to augment the definition and expand the scope of universal service. States are in a better position to more finely tune the definition of universal service to match the capabilities of the network and consumer demand. In addition, states are capable of coordinating rates and support. As we will discuss below, the Commission does not need to assume the entire responsibility for ensuring universal service.

California believes it is important to have a high cost assistance program of the correct scope in order that consumers are not overburdened in funding the new program. A recent report suggests that at a \$30 dollar benchmark using cost estimates of the Benchmark Cost Model II, applied to the funding base proposed by the Joint Board and assessing both intra and interstate revenue of interstate providers, California would be the greatest net payer to the federal fund at an amount of \$528 million per year.² California's contribution would be reduced to \$405 million per year if only interstate revenue were assessed.³ California urges the FCC to consider the burden on consumers that a modified high cost fund will create when determining the size of the fund. Such a fund would be a 4-5% levy on California telecommunications providers. Any subsidy collected in this fashion has the effect of distorting the telecommunications marketplace. As the funding

²The Revenue Base for Federal Universal Service Support, Staff Subcommittee on Communications of the National Association of Regulatory Utility Commissioners (NARUC), December 8, 1996, Attachment "BCM2 Option 2-B." The Telecommunications Industry Analysis Project (TIAP) assisted in doing the report.

³ Id, Attachment "BCM2 Option 1-B"

requirements increase, the amount of the distortion rises. The basic question the CPUC faced in California, and the question the FCC faces, is how much of this levy should we place on the consumption of telecommunications, a basic input of the information age economy. Telecommunications intensive industries, the very foundation of the information economy, will bear a large part of this burden. As a nation we must be careful to balance our universal service policy goals with our objectives for economic growth and development.

2. The Commission Should Adopt A Cost Based Benchmark.

California believes that the best way to ensure that the fund is appropriately directed to high cost areas is to adopt a cost-based benchmark. Accordingly, California's recent universal service decision adopted a cost-based benchmark.⁴ California believes that such a benchmark is even more essential for a federal universal service fund. When rejecting the cost-based benchmark, the Joint Board acknowledged that the use of a revenue benchmark may not be appropriate for the long term due to changes in the market place.⁵ California believes that the market is already changing such that a revenue benchmark would be unstable. For example, one of the component rates of the Joint Board's revenue benchmark, access revenue, will be reviewed by the Commission shortly. A cost-based benchmark set above the current level of revenues would be more stable than a revenue based benchmark. For example, only areas that

⁴ CaPUC D.96-10-066.

are 150% above the nationwide average cost, as determined by the proxy model chosen by the Commission, should receive high cost assistance. Once the Commission has identified high cost areas using this cost benchmark, it can determine the level of support directed to high cost areas independently. For example, if the nationwide average cost is \$24 and the benchmark \$36, in an area where the cost is \$60, the Commission can provide support in addition to the difference between the cost and benchmark.

A nationwide revenue benchmark is superior to a rate-based benchmark because it results in more narrowly focused high cost support, but shares some of the same problems in terms of its circular effect on local rates. A rate-based benchmark would take into account only the local rates charged by carriers, while a revenue benchmark would take into account other revenues beyond the basic local rate, such as access and discretionary service revenue. Since a national revenue benchmark is based on an average of revenues that fluctuate above and below the benchmark, many of the supported lines will generate revenues in excess of the benchmark. Local rates that comprise the benchmark in these over-compensated areas will most likely be forced down due to competitive pressure or through regulatory action seeking to avoid the competitive problems addressed by 254(k), even though they are currently affordable. The decline in rates that comprise the benchmark will lead to a lower benchmark, and in turn a larger fund which will put upward pressure on other

⁵ Recommended Decision 317

rates. All of this will occur even though the current rate structure is affordable to most consumers. California believes that a cost-based benchmark will avoid many of the circular effects of a revenue-based benchmark.

3. The Commission Should Rigorously Examine Proxy Model Cost Estimates

California believes that the Commission should rigorously examine the cost models that have been presented prior to adopting support levels based on them. California supports the forward looking cost approach articulated by the Joint Board in Paragraph 277 of the Recommended Decision. California believes the FCC should pursue the rigorous examination of cost estimates begun in Appendix F. Based on its recent experience, California suggests that the FCC take a close look at the following issues: the appropriate cut-off between fiber and copper feeder given the definition of universal service; the level of rearrangement costs necessary for supporting primary lines where warm lines policies exist; the allocation of shared retail costs when revenues from some services billed to residential customers are included in the benchmark and others are not; and the level of common corporate overhead costs associated with basic service. California notes that the costs adopted by the CPUC include services which will not be supported by the federal fund, such as a directory assistance calling allowance and an optional white page listing. Therefore, the FCC must make certain the costs associated with these services are not reflected in the cost estimates.

California also suggests that the Cost Proxy Model (CPM), which has been adopted in California with modifications, has many virtues that the Joint Board has not taken into account. The model is extremely flexible and easy to use. The model is capable of generating costs on any number of geographical bases, e.g., census block group or wirecenter. The grid cell structure also helps locate households where they are actually located. In addition, since the CPM is the only model that does not rely on the Benchmark Cost Model structure, it represents a substantive alternative. The proprietary nature of the CPM has been exaggerated; the model could be populated using publicly available sources.

4. Section 214(e) Gives States Authority to Determine Eligible Carriers and Exercise Discretion Concerning Obligations Applied to those Carriers

The Joint Board found that any carrier that met the eligibility criteria contained in section 214(e)(1) (e.g., offers and advertises universal service throughout the service area) should be eligible to receive universal service support. The Joint Board rejected the argument that additional requirements must be imposed on carriers before they may receive universal service support. For example, some commenters contended that these requirements include carrier of last resort (COLR) obligations.

While California believes that the Joint Board is correct that it is inappropriate for the FCC to designate a national standard beyond that articulated in section 214, states under that same section can set forth their own

standard. Section 214 (e) (2) states “the State commission shall find that the designation is in the public interest.” In California’s Universal Service Decision (D.) 96-10-066, the CPUC found that for a telecommunications carrier to be eligible for funding from the high cost fund, it had to be a COLR. California took this position because it believes that universal service in California’s high cost areas would be jeopardized if such carriers are not COLRs. Thus, California has made a finding that it is in the public interest to require a carrier to be a COLR in order for that carrier to receive high cost funding.

B. The Commission Should Coordinate Low Income Assistance Programs with Existing State Programs

California supports many of the proposed changes to federal low income support included in the Recommended Decision. Placing Lifeline and Link-Up funding on a competitively neutral basis and encouraging new entrants to participate are essential reforms. The Joint Board’s recommended requirement that voluntary toll limitation be offered to lifeline customers free of charge should also help increase subscribership among low income consumers. California is concerned, however, that some of the changes designed to make lifeline support available to all low income consumers, including those in states that do not currently participate in the program, and to increase the value of federal benefits may have little effect other than shifting the burden of supporting low income programs from the state to the federal jurisdiction.

The amount of baseline support is unlikely to have an impact on the amount that California’s low income, lifeline eligible consumers pay for telephone

service. This is significant since 2.8 million lifeline consumers, or 57% of the national total, reside in California.⁶ The reason there would probably be no impact is that California has a statewide lifeline rate. All competitive local exchange carriers (CLECs) and incumbent local exchange carriers (ILECs) must charge these rates regardless of their standard rate or whether or not they are eligible for high cost assistance.⁷ The Joint Board's proposal to increase the baseline support would probably result in a share of the funds California currently devotes to reimbursing lifeline discounts being subsumed under federal jurisdiction. In 1995, California spent \$380 million on lifeline support.

California has a particular interest in the baseline amount of federal low income support. The current equivalent of the baseline is the \$3.50 value of the waiver of the subscriber line charge. California currently receives 50% of that amount because it allows self-certification of lifeline eligibility. To our knowledge, California is the only state that participates in the federal program without verifying eligibility. California suggests a similar structure which provides a reduced level of federal support for states that allow self-certification. The CPUC has recently directed its staff to investigate the possibility of income verification, including the link between income verification and federal support.⁸

California also is in a unique position with respect to the Federal Link-up program. California does not participate in the Federal Link-up program, but

⁶ 1995 Monitoring Report, Table 2.3.

⁷ CaPUC D.95-12-056, Appendix C, Rule 9.

⁸ CaPUC D.96-10-066, pp. 236-237.

rather supports service connection and service installation through its state program, the Universal Lifeline Telephone Service (ULTS). We encourage the FCC to coordinate the reformed federal Link-up effort with existing state efforts to achieve the greatest results from both, without duplicating resources.

California makes two suggestions concerning the federal low income programs. First, all carriers, not just eligible carriers, should be able to participate in the federal lifeline program. The restrictions on exit placed on eligible carriers may be an appropriate condition for high cost assistance, but serve no purpose for low income programs. In addition, at the outset of local competition, many carriers plan to operate on a purely resale basis; this will preclude them from becoming eligible carriers.⁹ Allowing all carriers to participate in the low-income program will engender competition to serve low-income customers. Because the subsidy is portable across a greater number of carriers, there will be greater outreach and marketing to these economically disadvantaged customers. Limiting the carriers that can participate in the low-income program will decrease the level of competition in the market. Depending on the relationship between costs and the benchmark, eligible carrier status may be irrelevant in urban areas. It may be appropriate to require carriers to offer lifeline service as a condition on

⁹ Recommended Decision 161.

eligible carrier status, but not that eligible carrier status be a condition of lifeline participation.¹⁰

Secondly, California would like to preserve the idea of eligibility standards based solely on income factors. California's ULTS currently has a means test based on 150% of the poverty line. We believe that this is appropriate and should continue as the appropriate standard to utilize in California.

C. Funding and Administration

1. States Should be Allowed to Collect Universal Service Support through Retail Surcharges

California believes that states should be allowed to fund intrastate universal service programs using end user surcharges on retail revenues. While the FCC may find the gross revenue approach recommended by the Joint Board appropriate for the federal fund, California urges the Commission not to make any conclusions or findings that would inhibit states from adopting a different system. California is concerned about certain aspects of the gross revenues based system, but is mainly interested in retaining the ability of states to fund universal service in other competitively neutral ways.

Retail surcharges are a competitively neutral way to collect revenues to support universal service programs. In addition, a retail based surcharge obviates the problem that the Joint Board acknowledges concerning the

¹⁰ This condition may have to be reconciled with the Joint Board's recommendation that the Commission not impose eligibility criteria in addition to those contained in section 214(e)(1). Recommended Decision 155.

collection of surcharges based on revenue generated from cost-based unbundled network element prices.¹¹ The Recommended Decision's resolution of this problem is somewhat opaque and could benefit from clarification. It is uncertain who is expected to pay the universal service fund: the provider of network elements appears to be precluded from recovering the costs of universal service through its wholesale rates, and the identity of the "user" of unbundled network elements is unclear.

Some parties have argued that the Act prohibits end user surcharges because it indicates that carriers must contribute;¹² this argument makes no economic sense. Much like a tax, the degree to which carriers or consumers will pay for a universal service assessment is dictated by the characteristics of the market, i.e., the elasticities of supply and demand, not the mechanics of collection.¹³ A surcharge increases the price that consumers must pay for telecommunications services, thereby reducing the quantity of services purchased. The producer pays for this assessment in terms of lost revenue. The burden of universal service will be born mostly by the consumer if the demand is relatively inelastic and supply relatively elastic, and on the carrier if the demand is elastic and supply inelastic. To suggest that somehow carriers will pay or absorb a greater share of the assessment than consumers if a gross revenues

¹¹ Recommended Decision 808.

¹² Texas Office of Public Utility Counsel 805.

¹³ Microeconomics. Robert Pindyck and Daniel Rubinfeld, 1989, pp. 319-320.

based approach is used rather than a retail surcharge is a fallacy with no economic foundation.

Another reason that states ought to be allowed to finance universal service programs through explicit surcharges is that this method is an established, effective means of collection often mandated by state legislatures. California collects revenues for three existing universal service programs via end user surcharges: the Deaf and Disabled Telecommunications Program, the ULTS and the California High Cost Fund. Millions of consumers depend on these programs. Placing the funding for these programs in jeopardy would not advance the goals of universal service. In addition, the California legislature mandated the end user surcharge for the Commission's Deaf and Disabled Telecommunications Program which has served as the successful model for other public purpose programs.¹⁴

California is encouraged that the Joint Board confirmed the ability of states to require Commercial Mobile Radio Service providers to contribute to state universal service programs.¹⁵ Only by assessing all carriers on a similar basis can states implement competitively neutral universal service funds.

2. The Commission Should Carefully Consider the Revenue Base for the Universal Service Program

The Joint Board recommends that universal service support mechanisms for schools and libraries and rural health care providers be funded by assessing

¹⁴ California PU Code Section 2881(d).

both the intrastate and interstate revenues of providers of interstate telecommunications services.¹⁶ The Joint Board makes no recommendation concerning the appropriate funding base for the modified high cost and low income assistance programs, but requests that the Commission seek additional information and parties' comment, particularly the states, regarding the assessment method for these programs. (Id.)

California raised concerns over the FCC's assessing support payments from intrastate revenue sources in its Comments on the Notice of Proposed Rulemaking. While California acknowledges that raising revenue on the basis of jurisdiction may be increasingly difficult, California believes that there may be technical and legal problems with assessing both the intra and interstate revenues of providers of interstate services. California believes that separating revenue by jurisdiction may become more difficult in the converging telecommunications market. Yet, it can nevertheless be done through self reporting mechanisms similar to those now in use for the Telephone Relay Service. In addition, if assessment rates on inter and intrastate revenues differ significantly, there may be an incentive to avoid the higher assessment rate. In the context of the formal Part 36 separations process there may be a check, but this would not apply to new entrants not subject to separations rules. Nonetheless, California cautions that the incentive to avoid assessment will exist whether the distinction is between inter and intrastate revenues, or inter and

¹⁵ Recommended Decision 791.

intrastate providers. While there are few purely intrastate providers now, if there is a significant advantage to becoming such a provider, such providers will emerge.

California does not believe that the school and library program is sufficiently more predictable than the high cost program to justify a different treatment of funding. Although not explicitly stated, presumably the Joint Board believes that the size of the schools and library fund is more certain because of the \$2.25 billion annual cap thereon.¹⁷ Nevertheless, California notes that sufficient uncertainty surrounds the size of the federal schools and libraries fund, and that the Joint Board's conclusion may not be well-founded.

Specifically, the Separate Statement of Commissioner Rachelle B. Chong raises concerns over the Joint Board's proposed funding of discounts relating to internal connections costs¹⁸. Such costs could cause the fund to balloon to a level much higher than may be fiscally prudent. Commissioner Chong's Statement cites two estimates of the undiscounted costs of connecting schools which range from \$5.025- \$6.11 billion in initial costs and \$410-\$560 million per year for annual recurring costs. (Separate Statement of Rachelle B. Chong, p. G-6.) Based upon these estimates, the portion of the universal service fund applicable to discounts for schools and libraries could face a funding crisis during

¹⁶ Recommended Decision 817

¹⁷ Recommended Decision 440.

¹⁸ This class of products and services includes wiring, routers, hubs, network file servers, wireless local area networks (LANs), and the installation and maintenance costs of inside wire. Recommended Decision 474 and 478.

its first year of operations, with worsening deficits in the years to come. Such a contingency does not inspire confidence over the predictability and sustainability of the funding requirements of the Joint Board's proposed schools and libraries program.

California believes that the FCC must also address the arguments included in the Dissenting Statement of Commissioner McClure. As Commissioner McClure observes, by delineating separate, parallel funding mechanisms for interstate and intrastate universal service programs, the 1996 Telecommunications Act may indicate that, regardless of the funding purpose, only interstate funds should be assessed for funding the federal Universal Service Program. Specifically, Section 254 (d) states that "every telecommunications carrier that provides *interstate* telecommunications services must contribute to preserve and advance universal service. Further, Section 254 (f) provides:

A State may adopt regulations not inconsistent with the Commission's rules to preserve and advance universal service. Every telecommunications carrier that provides intrastate telecommunications services shall contribute, on an equitable and nondiscriminatory basis, in a manner determined by the State to the preservation and advancement of universal service in that State.

California believes that the Act appears to maintain the traditional roles of both federal and state regulators' authority to assess support payments. Each may

assess support payments solely from revenues of their respective regulatory jurisdictions.

The Act, by requiring every telecommunications carrier that provides *interstate telecommunications services* to contribute to the Commission's universal service support mechanisms, intends to preserve the current interstate/intrastate distinction for purposes of collecting support payments. Section 254(e) of the Act requires that universal service support be explicit. The goal of replacing existing implicit subsidies with explicit sources would be hindered if the FCC were to assess revenues over which it has no jurisdiction.

IV. CONCLUSION

California believes that the Joint Board's Recommended Decision provides a good framework for federal universal service policy. California urges the Commission to direct high cost assistance to high cost areas, coordinate federal low income programs with state programs and carefully consider the

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problems associated with assessing intrastate revenues to fund the federal universal service program.

Dated: December 18, 1996

Respectfully submitted,

PETER ARTH, JR.
LIONEL B. WILSON
MARY MACK ADU
GRETCHEN DUMAS

By:

A handwritten signature in black ink that reads "Mary Mack Adu". The signature is written in a cursive, flowing style. Below the signature is a horizontal line.

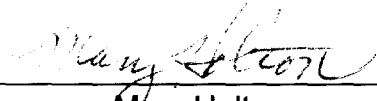
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Commission of the State of California

CERTIFICATE OF SERVICE

I, Mary Holton, hereby certify that on this 18th day of December, 1996, a true and correct copy of the foregoing COMMENTS OF THE PEOPLE OF THE STATE OF CALIFORNIA AND THE PUBLIC UTILITIES COMMISSION OF THE STATE OF CALIFORNIA ON THE RECOMMENDED DECISION in FCC Docket No.96-93, CC Docket No. 96-45, was mailed first class, postage prepaid to all known parties of record.



Mary Holton